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Competition Taskforce
The Treasury
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PARKES ACT 2600

SUBMISSION

Non-competes and other restraints: understanding the impacts on jobs, business and productivity

1. Background

- 1.1. I am a barrister who has practised in employment law at the NSW and English Bars. I am the co-author of leading textbook, *The Modern Contract of Employment* (3rd ed) and a contributor to the UK employment law textbook *Tolley's Employment Handbook*.
- 1.2. I regularly advise on, and occasionally litigate, employment disputes involving restraints of trade on behalf of employers and employees.
- 1.3. This submission focuses, in particular, the appropriateness of post-termination restraints of trade and reforms which might adopted in this area.

2. Discussion Questions 1-5 (Post-termination worker restraints of trade)

2.1. The restraint of trade doctrine undermines certainty and serves no-one

2.1.1. Certainty should be the primary objective of any law governing a contractual relationship like employment. Employers and employees should know exactly where they stand; what they can and cannot do. This is particularly important where – as in the case of a post-termination restraint of trade – the contract continues to determine what a person can or cannot do once the relationship has come to an end. The restraint of trade doctrine undermines certainty in a way that is disruptive and expensive for business, and which can be unfair and oppressive for employees.

2.1.2. Employers need to know and understand what legal protections they are truly entitled to without the need for court intervention. For an employer, being able to ensure that key employees do not set up in competition, solicit customers or misuse confidential information is critical. Contractual provisions protecting against these risks will (for certain employees) form an essential part of the bargain and will factor into the decision about (a) what to pay the employee; and (b) the level of trust and responsibility to give them. Notwithstanding the importance of such provisions, the restraint of trade doctrine leaves employers largely in the dark about whether they will ultimately be entitled to the protection that they seek. It is the contractual equivalent of buying a car you are told has airbags, but being told that the airbags will only deploy if the Court thinks that it is reasonable for them to deploy. The Court will generally only pronounce its view once the car has already been wrapped around a telegraph pole.

2.1.3. Equally, employees should be able to look at their employment contract and know what they can and cannot do once they leave their employment. If they do not have legal training or cannot afford legal advice, they will rarely be aware that the restraints in the contract may well be unenforceable (or enforceable, but only in a less restrictive way). In my practice I am regularly consulted by employees trying to understand the impact of post-termination restraints in their contract on what they can and cannot do. The advice I can give is always qualified because of the uncertainty in what attitude the Court will take to evaluating the reasonableness of the restraint. Even when I can advise that I think the restraint is unenforceable, many clients are so concerned about the prospect of their previous employer going to court to stop them working for a competitor or setting out on their own, that they will elect to wait out their restraint period (potentially experiencing considerable financial hardship as a consequence).

2.1.4. This an area where there is a genuine need for some bright lines. Legislative reform is required.

2.2. The Restraints of Trade Act 1987 (NSW) (ROT Act) does not promote certainty

2.2.1. There are three differences in the way that the restraint of trade doctrine operates in NSW as a consequence of the ROT Act. *First*, (as the issues paper identifies) it adopts the starting position that restraints are presumed to be reasonable and enforceable, reversing the common law position that they are void and unenforceable. *Second*, the

Act permits the Court to effectively rewrite the restraint to make it reasonable (as opposed to adopting the blue pencil rule that applies in other jurisdictions). *Third*, it requires the reasonableness of the restraint to be assessed in relation to its effect on a particular act said to constitute a breach of it. This final point is important and not one which appears to have been identified in the Issues Paper.

2.2.2. Other than in NSW, the court will determine the validity of the restraint based only on the nature, scope and extent of that restraint as it is drafted in the contract. In some ways this makes it easier to advise on the likelihood of a particular restraint being upheld or not, because it is not necessary to consider any particular step that the employee might or might not take.

2.2.3. In contrast, the ROT Act considers the reasonableness of the restraint by reference to the particular act which is said to constitute a breach: see *Isaac v Dargan Financial Pty Ltd ATF the Dargan Financial Discretionary Trust* (2018) 98 NSWLR 343 at [61]-[62]. In other words, the Court does not ask whether the restraint is reasonable on its own terms, but whether it is reasonable by reference to what it is the employee has done, or wishes to do.

2.2.4. This approach creates difficulties for employers seeking advice on the enforceability of their restraints because they frequently will not be aware of what an employee might do after leaving their employment. Similarly, an employee wanting advice on the efficacy of a restraint will need to have a good idea of what it is they propose to do that might be in breach of the restraint.

2.2.5. Further, the Court's ability to rewrite the restraint to make it a reasonable one creates a much wider range of possible outcomes left broadly to the Court's evaluation. In contrast, the blue pencil approach used in jurisdictions other than NSW (which permits only the deletion of words from the contract) limits the range of possible outcomes (even where a cascading restraint of the kind referred to on page 13 of the Issues Paper is used).

2.3. Policy approaches of other countries

2.3.1. The countries identified on page 25 of the Issues Paper limit (or propose to limit) the use of restraints in a range of ways which range from banning them entirely to allowing restraints of only limited duration (possibly contingent on a certain income

threshold having been met). I would not propose or endorse the use of any one of these mechanisms in the Australian context.

2.3.2. **A total ban?** The need for restraints in some circumstances, for particular employees, is unlikely to be controversial. The archetype of such a person is someone who plays a senior role in a business who has extensive personal connections with the employer's customers and knowledge of the employer's confidential information (for example, sales strategy and pricing information). A total ban on restraints would leave employers considerably exposed to unfair competition that would arise if such employees were free to leave and work for a competitor without limitations.

2.3.3. **Limiting duration - the UK proposal** Limiting the duration of restraints would do little. The UK proposal to confine restraints to 3 months would provide inadequate protection against unfair competition from employees in respect of whom protection may clearly be needed. Furthermore, the UK proposal needs to be understood holistically. Two points are relevant:

2.3.3.1. The proposal does not appear authorise restraints of up to three months as a general rule. Rather, it limits the maximum duration of a restraint leaving the question of the restraint's reasonableness and enforceability under the restraint of trade doctrine open: see *Non-Compete Clauses: Response to the Government consultation on measures to reform post-termination non-compete clauses in contracts of employment*, 12 May 2023¹ (**UK Government Response**), p 21. It does little to resolve the certainty problem.

2.3.3.2. The proposal applies only to non-compete clauses. It does not apply to (for example) limitations on solicitation of clients and staff or limitations on dealings with previous customers and suppliers. Indeed, the UK Government appears to have been conscious about the risk of businesses strengthening their reliance on other kinds of protections if non-compete clauses were banned outright: see UK Government Response, p 24. Again, this does little to resolve the certainty problem

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1156211/non-compete-government-response.pdf

2.3.4. On a review of the countries where restraints are limited but longer durations are permitted, there appears to be an obligation to compensate the employee for the restraint once their employment ends. This approach is one which is worth exploring in the Australian context (as discussed further below).

2.4. Policy options available

2.4.1. Any policy options adopted should deliver certainty in this area.

2.4.2. To that end, there are three policy options that should be considered:

2.4.2.1. Pre-contractual approval of restraints

2.4.2.2. Mandatory compensation during the restraint period

2.4.2.3. Defined eligibility for restraint periods – minimum income requirement

2.4.3. **Pre-contractual approval of restraints** One option may be to require that pre-approval of a proposed restraint provision be sought by a body like the Fair Work Commission. The approval could be assessed in the same way that a court would determine the enforceability the provision by reference to the restraint of trade doctrine. However, by requiring approval at the outset, it would give the parties clarity on their respective positions at the outset of the employment relationship. The Commission already serves an analogous function in the setting of award conditions and the approving of enterprise agreements. Further, seeking approval at the commencement of an employment contract is broadly consistent with the way that the restraint of trade doctrine operates in practice. That is, the Court looks at the reasonableness of the restraint from the position of the parties at the time they entered into the contract: see *Isaac* at [63].

2.4.4. A requirement for pre-approval would almost certainly operate as a disincentive to the more frivolous uses of restraints in employment relationships that do not truly require them.

2.4.5. Any requirement for pre-approval would need to be national in order to be effective. If it were not, parties may be able to organise their affairs to avoid the requirement. There will inevitably be some employers and employees to whom such a requirement

could not apply due to constitutional limitations, but the requirement could extend at least as far as the coverage of the *Fair Work Act 2009* (Cth). Most employers who are not captured would likely be public servants who are not typically subject to restraints.

2.4.6. Mandatory compensation during the restraint period The form of regulation adopted in Finland, Germany, the Netherlands, and Spain appears to permit substantial restraint periods of 6-24 months but subject to a requirement that the employee receive a minimum proportion of their pre-termination earnings during the post-employment period.

2.4.7. One option for reform may be to permit restraints subject to payment of a minimum amount of compensation being paid to the employee

2.4.8. This is an attractive option because it would essentially enable a separate “price” for the restraint to be identified. The quantification of the economic cost of a restraint would compel employers to seriously weigh up the necessity for the restraint before requiring one. It would also enable employees to fully appreciate the potential cost to them of the restraint and to weigh that as a consideration in their salary negotiations.

2.4.9. Requiring an employee to be paid an appropriate percentage of their pre-termination earnings would also have the advantage of ensuring that employees who are subject to a restraint do not experience financial hardship because they cannot take up work in an area in which they specialised for an extended period of time.

2.4.10. Some care would be required in the implementation of such a proposal. It is not a complete answer. In particular, it would not assist in determining the extent to which a particular restraint was reasonable in a particular role. For example, in some roles the mere payment of compensation would not be enough to make a long restraint reasonable. There are certain roles where an employee needs to keep their skills current (for example, surgeons) or where the employee’s value depends on their ability to be seen to ply their trade (for example, actors, musicians, television presenters).

2.4.11. This possibility was canvassed by the UK Government and rejected on the basis that the direct costs to business would be too high: UK Government Response, p 4. However, that concern appears to have been based not on the costs being objectively too high, but on the costs being too high in the UK’s present economic circumstances:

UK Government Response, p 11. Notwithstanding this, it is notable that more than 60% of respondents to the UK Government's consultation supported the proposal: UK Government Response, p 6.

2.4.12. **Defined eligibility for restraint usage - minimum income requirement** Greater certainty could be provided by ensuring that post-contractual restraints could only be used for employees who earn a minimum income. At present, such provisions may be included in any employment contract, but will only be enforceable where there is a legitimate interest of the employer to be protected.

2.4.13. Typically, although not invariably, the kinds of employees for whom a restraint is appropriate are high income earners, reflecting their value to the business. Further, it is likely that a high income earner will be (a) better placed to properly negotiate the restraint; (b) less likely to suffer hardship as a consequence of the restraint; and (c) more likely to be in a position to obtain advice about the lawfulness of the restraint.

2.4.14. Adopting a minimum income requirement (as appears to be in place in Austria: see Issues Paper, p 25) would be a blunt instrument, and will prevent the use of post-termination restraints in some employment relationships in which such a restraint might otherwise be justified, but would provide a principled bright line that is much needed in this area.

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